

## Message Text

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FM AMEMBASSY STOCKHOLM

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E.O. 11652: N/A

TAGS: EFIN, SW

SUBJECT: 1977/78 BUDGET PROPOSAL

SUMMARY: SWEDEN'S RECENTLY ELECTED NON-SOCIALIST GOVERNMENT PRESENTED TO THE RIKSDAG ON JANUARY 10 A BUDGET PROPOSING THE LARGEST DEFICIT IN SWEDISH HISTORY: 16 BILLION KRONOR. GOVERNMENT RECEIPTS WOULD RISE TO 109 BILLION KRONOR (102 BILLION IN 1976/77) AND EXPENDITURES TO 125 BILLION (116 BILLION IN 1976/77). THE NEED TO MAINTAIN SWEDEN'S HIGH LEVEL OF EMPLOYMENT IN THE FACE OF RELATIVELY GLOOMY PERCEPTIONS OF SWEDEN'S ECONOMIC PROSPECTS IN 1977 WAS THE LEITMOTIF. AVERAGE TAXPAYERS WOULD HAVE SOME INCOME TAX RELIEF, BUT A GOOD BIT OF THAT WOULD BE OFFSET BY HIGHER TAXES ON SPECIFIC GOODS AND SERVICES IN ORDER TO RESTRICT THE GROWTH OF PRIVATE DEMAND. CERTAIN INDUSTRIES CAN EXPECT SUBSIDIES, BUT THE GOVERNMENT'S PROPOSALS WERE SHORT OF WHAT MANY BUSINESSMEN BELIEVE NECESSARY. SWEDEN'S COMPETITIVE SITUATION IN

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FOREIGN TRADE, WHICH HAS GROWN STEADILY WORSE IN RECENT YEARS DUE TO RAPIDLY RISING LABOR COSTS AND SLACKENED FOREIGN DEMAND, WILL RESULT IN A CURRENT ACCOUNT DEFICIT OF 12 BILLION KRONOR IN 1977, ACCORDING TO THE GOVERNMENT. AS A RESULT, SWEDEN WILL NEED TO BORROW 16 TO 18 BILLION KRONOR ABROAD DURING THE YEAR. IN ORDER TO FACILITATE BORROWING OF THIS MAGNITUDE, THE GOVERNMENT

ITSELF WILL ENTER INTERNATIONAL MONEY MARKETS FOR THE FIRST TIME IN THIS CENTURY.

THE BUDGET PROPOSAL RECEIVED MORE THAN ITS SHARE OF CRITICISM FROM BOTH THE OPPOSITION AND LABOR ON ONE SIDE AND BUSINESS ON THE OTHER. SOME THOUGHT THE BUDGET TOO INFLATIONARY, OTHERS THOUGHT IT TOO CONTRACTIONARY. ONE PROMINENT ECONOMIST WAS PROMPTED TO REMARK THAT ONE WOULD NEED A MAGNIFYING GLASS TO DISTINGUISH BETWEEN THIS BUDGET AND SOCIAL DEMOCRATS' BUDGETS IN RECENT YEARS. DEBATE IN THE RIKSDAG WILL LAST UNTIL APRIL WHEN A FINAL BUDGET IS VOTED.

ONE THE WHOLE, WE BELIEVE THE GLOOMY ECONOMIC PICTURE IS PROBABLY SOMEWHAT EXAGGERATED IN ORDER TO BRING MAXIMUM PRESSURE ON LABOR. SWEDEN STILL HAS SEVERAL YEARS' LEEWAY IN ITS EFFORT TO WEATHER THE RECESSION WHICH HIT OTHER DEVELOPED COUNTRIES IN THE MID-1970'S WITHOUT THE TRAUMA OF HIGH UNEMPLOYMENT. SWEDEN'S CREDIT RATING REMAINS HIGH AND ITS ECONOMY STRONG. SHOULD THE GOVERNMENT FAIL TO ACT WITHIN THE NEXT TWO YEARS TO PROMOTE A RATIONALIZATION OF PRODUCTION AND RESTRUCTURING OF THE ECONOMY AWAY FROM HIGH COST INDUSTRY, SERIOUS TROUBLE WOULD CERTAINLY BE IN THE OFFING. THE SWEDES' DREAD OF THE "ENGLISH DISEASE" (IE., STAGFLATION) WILL STAND THEM IN GOOD STEAD HERE. THE MOST LIKELY PROBLEM IS THAT WE MAY SEE SPECULATION ON A DEVALUATION OF THE KRONOR WHICH WOULD DELAY THE FOREIGN BORROWING NECESSARY TO PAPER OVER CURRENT ACCOUNT DEFICITS. WAGE INCREASES ABOVE THE GOVERNMENT'S GUIDELINES MIGHT ALSO ADD TO THE PRESSURE FOR DEVALUATION, AND THE GOVERNMENT'S NEED TO LIMITED OFFICIAL USE

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PROTECT ITS OWN DEBT FROM DEVALUATION MIGHT ACTUALLY HASTEN SUCH A STEP.

AS FAR AS THE US IS CONCERNED, WE SEE NO LIKELIHOOD OF RESTRICTIVE MEASURES AIMED DIRECTLY AT IMPORTS AND ANTICIPATE THAT THE FAVORABLE BALANCE OF TRADE WHICH WE ENJOY WITH SWEDEN WILL CONTINUE. ON THE OTHER HAND, THE CHORUS OF CRIES FOR THE US TO SAVE SWEDEN BY GROWING MORE RAPIDLY WILL INCREASE. END SUMMARY.

1. THE FIRST NON-SOCIALIST BUDGET IN 44 YEARS WAS PRESENTED TO RIKSDAG ON JANUARY 10. FINANCE MINISTER BOHMAN AND BUDGET MINISTER MUNDEBO MADE NO BONES ABOUT THE FACT THAT THE 1977/78 BUDGET PROPOSAL WAS THE RESULT OF EXTENSIVE COMPROMISE UNAVOIDABLE IN A THREE-PARTY COALITION OR ABOUT THE FACT THAT THE BUDGET WOULD CHANGE LITTLE FROM PAST SOCIAL DEMOCRATIC BUDGETS. THEY COULD HARDLY HAVE DONE OTHERWISE AFTER ONLY THREE MONTHS IN OFFICE. THE FY 78 PROPOSAL, WHICH IS DIVIDED INTO A GENERAL ECONOMIC OUTLOOK SECTION (BOHMAN) AND A FORMAL

MINISTERIAL BUDGET PRESENTATION (MUNDEBO), HAS FOUR PROMINENT FEATURES: (A) CONTINUITY WITH PAST BUDGETS (ONE MIGHT COMPARE THE AUTOMATICITY OF MANY EXPENDITURES WITH THE US BUDGET); (B) A COMMITMENT TO FULL EMPLOYMENT; (C) A DECISION THAT THE GOVERNMENT ITSELF WILL BORROW ABROAD (FOR THE FIRST TIME IN THIS CENTURY); AND (D) AN ATTEMPT TO JAWBONE LABOR INTO ACCEPTING MODERATE WAGE INCREASES.

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2. THE ECONOMIC PICTURE WHICH BOHMAN PAINTS IS CERTAINLY BLEAK BY SWEDISH STANDARDS. HE SEES THE CURRENT ACCOUNT DEFICIT GROWING TO SKR 11.3 BILLION, 3 BILLION MORE THAN IN 1976. SLOWER GROWTH OF FOREIGN DEMAND FOR SWEDISH EXPORTS WILL BE EXACERBATED BY HIGH SWEDISH EXPORT PRICES, PRICES WHICH HAVE BEEN FORCED UPWARDS BY VERY LARGE INCREASES IN LABOR COSTS OVER THE LAST TWO YEARS. A DROP IN INDUSTRIAL PRODUCTION IN SWEDEN THIS YEAR IS INEVITABLE. ALTHOUGH THERE HAS BEEN LITTLE INCREASE IN UNEMPLOYMENT TO DATE, RELIEF WORK, RE-TRAINING AND OTHER GOVERNMENT PROGRAMS HAVE DISGUISED THE TOTAL FIGURES AND LAYOFFS ARE INCREASING. (ACCORDING TO EMBASSY FIGURES, LAYOFFS ARE APPROACHING THE 1971 RATE.) IF ANYTHING, THE SITUATION WORSENEDED IN THE FOURTH

QUARTER, ACCORDING TO BOHMAN. THE KONJUNKTUR INSTI-  
TUTET (THE ECONOMIC RESEARCH INSTITUTE, CALLED KI)  
FOUND THAT INCOMING INDUSTRIAL ORDERS WERE WELL DOWN  
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IN THAT QUARTER AND EXPORT ORDERS WERE ESPECIALLY SLOW.  
INCOMING ORDERS HAD BEGUN TO TAPER OFF IN THE SECOND  
HALF AFTER A STRONG SURGE IN THE FIRST SIX MONTHS.

3. THIS ANALYSIS LED THE GOVERNMENT TO ADOPT AN  
EXPANSIONARY FISCAL POLICY. THE DECISION WAS ALSO  
AFFECTED BY THE SUBSIDIARY JUDGEMENT THAT A SHARP  
REVERSAL OF FISCAL POLICY TO IMPROVE THE TRADE BALANCE  
AND LIMIT INFLATION MIGHT CREATE A PSYCHOLOGICAL CLI-  
NATE WHICH WOULD PRECIPITATE A SERIOUS RECESSION (THIS  
OPINION CONFIRMED TO EMBOFFS PRIVATELY BY UNDER SECRE-  
TARY FOR COMMERCE). THE 'RESULT' IS A PROPOSAL WHICH  
WOULD YIELD THE LARGEST BUDGET DEFICIT IN SWEDISH HISTORY:  
SKR 15.7 BILLION.

TABLE I  
TOTAL BUDGET 1975/76 - 1977/78  
(IN MILLIONS OF KRONOR)

|                           | 75/76  | 76/77   | 77/78   |
|---------------------------|--------|---------|---------|
| INCOME                    | 93,934 | 101,874 | 109,254 |
| EXPENDITURE               | 97,658 | 116,269 | 125,002 |
| DEFICIT (-) SURPLUS(PLUS) | -3,724 | -14,396 | -15,748 |

THE KI HAD EARLIER ESTIMATED THAT FISCAL POLICY WOULD  
PROVIDE AN EXPANSIONARY IMPACT OF AROUND TWO PERCENT OF  
GDP. THIS ESTIMATE INCLUDED INCOME TAX REDUCTIONS  
ALREADY ON TAP FOR JAN. 1 AND OTHER MEASURES DUE TO  
GO INTO EFFECT UNDER THE 1976/77 BUDGET SUCH AS A 1.5  
PERCENT INCREASE IN THE PAYROLL TAX PAID BY EMPLOYERS.  
ACCORDING TO BOHMAN, THE KI ESTIMATE OF THE TOTAL STIMU-  
LUS INCLUDING THE FY 19UI BUDGET INDICATES A STIMULUS  
OF AROUND 3.5 PERCENT OF GDP.

4. WITH THIS REPAST AHEAD, THE GOVERNMENT NEVERTHELESS  
WOULD STILL LIKE TO HOLD ONTO SOME OF THE CAKE, AS WELL.  
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HENCE, GREAT EMPHASIS IS PLACED ON THE GOVERNMENT'S  
INTENTION TO HOLD THE INCREASE IN PRIVATE CONSUMPTION  
IN 1977 TO 2.5 PERCENT ABOVE 1976 IN REAL TERMS. THE

BRACING ACTION NECESSARY TO PROVIDE THIS RESULT WOULD  
COME FROM A SERIES OF SPECIFIC TAXES ON CONSUMPTION:  
A 15 PERCENT INCREASE IN ALCOHOLIC BEVERAGES AND  
TOBACCO TAXES WILL YIELD SKR 1,100 MILLION; A 75 PERCENT  
INCREASE IN ANNUAL AUTOMOBILE TAXES WILL YIELD 600  
MILLION; AND A 50 PERCENT INCREASE IN THE TAX ON HOME  
ELECTRICITY USE, 400 MILLION. AN INCREASE IN LICENSE  
FEES FOR TELEVISION WILL ADD ANOTHER UNSPECIFIED AMOUNT.  
THESE MEASURES MUST BE ENACTED SEPARATELY BY THE RIKS-  
DAG, AND ARE EXPECTED BEFORE JULY 1.

5. UNFORTUNATELY FOR THE GOVERNMENT'S DESIGNS AGAINST  
PRIVATE CONSUMPTION, REAL DISPOSABLE INCOME GOT A STRONG  
BOOST FROM REDUCTION IN MARGINAL INCOME TAX RATES  
WHICH TOOK EFFECT ON JAN. 1. THE AVERAGE SWEDISH  
INCOME-EARNER WILL ADD ROUGHLY 2,000 KRONOR TO HIS  
TAKE-HOME PAY AS A RESULT. THIS MEASURE WAS DESIGNED  
TO REDUCE THE HEAVY TAX BURDEN WHICH INFLATION HAS  
BROUGHT TO SWEDISH CITIZENS AS THEY MOVED UPWARD ON THE  
INCOME SCALE, AND TO FACILITATE THE ON-GOING WAGE  
NEGOTIATIONS, BUT WILL PROBABLY OFFSET THE TAX INCREASES  
LISTED IN PARA 4.

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6. SIMULTANEOUSLY WITH ITS EFFORT TO DAMPEN PRIVATE

CONSUMPTION EXPENDITURES, THE GOVERNMENT IS STIMULATING INVESTMENT. SPECIAL INVESTMENT SUBSIDIES AND DEDUCTIONS WILL CONTINUE AND INVESTMENT RESERVE FUNDS, WHICH WOULD HAVE BEEN AVAILABLE ONLY THROUGH MARCH, WILL NOW BE RELEASED THROUGHOUT 1977. SPECIFIC MEASURES, AIMED AT IMPROVING THE PERFORMANCE OF TROUBLED INDUSTRIES, WILL INCLUDE SKR 1.8 BILLION FOR THE FINANCIAL RECONSTRUCTION OF THE GOVERNMENT-OWNED STEEL PLANT (NJA). ANOTHER SKR 400 MILLION WILL BE PUMPED INTO THAT FIRM BY THE GOVERNMENT HOLDING COMPANY (STATEBRETAG). AID WAS ALSO PROMISED FOR THE SHIPBUILDING AND TEXTILE INDUSTRIES, AND A NEW BILL WAS INTRODUCED ON JAN. 12 TO PROVIDE SOME SKR 25 MILLION OVER A THREE-YEAR PERIOD IN AID TO THE TROUBLED CRYSTALL GLASS INDUSTRY. CONTRAST THIS LATTER MEASURE WITH SUBSIDIZATION OF THE ROYAL OPERA TO THE TUNE OF SKR 67 MILLION. MEASURES TO HELP SMALL AND MIDDLE SIZE FIRMS WILL INCLUDE AN LIMITED OFFICIAL USE

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INCREASE IN CREDIT GUARANTEES (FROM SKR 150 TO 200 MILLION); INCREASED LOAN FUNDS (FROM SKR 50 TO 90 MILLION); AND GREATER LENDING CAPACITY FOR THE GOVERNMENT INVESTMENT BANK (TO 8 PERCENT OF CAPITAL FROM 5 PERCENT). ON THE WHOLE, THESE MEASURES SEEM TO US TO BE LIMITED BY THE GOVERNMENT'S FEAR THAT TOO MUCH SUPPORT WILL HAMPER INDUSTRY'S ABILITY TO BECOME MORE COMPETITIVE IN INTERNATIONAL MARKETS. WE HAVE BEEN TOLD REPEATEDLY AT THE MINISTERIAL AND SUBMINISTERIAL LEVELS DURING THE LAST THREE MONTHS THAT THE GOVERNMENT DOES NOT INTEND TO CONTINUE LIFE SUPPORT MECHANISMS FOR DYING INDUSTRY INDEFINITELY; BETTER FOR ALL CONCERNED TO PULL THE PLUG AND GET IT OVER WITH.

7. IN NOVEMBER OF 1976 THE KI FOUND THAT EXISTING PLANS WOULD ADD UP TO A DECLINE OF 4 PERCENT IN INDUSTRIAL INVESTMENT IN 1977 OVER 1976. ACCORDING TO BOHMAN, THE STIMULI DESCRIBED BRIEFLY ABOVE WOULD TURN THAT FORECAST AROUND BY 6 PERCENTAGE POINTS: TOTAL INDUSTRIAL INVESTMENT IN 1977 WILL EXCEED 1976 BY 2 PERCENT. GROSS INVESTMENT WOULD BE SOME 3.6 PERCENT LARGER THAN 1976.

8. THE GOVERNMENT WILL ALSO CONTINUE TO PICK UP PART OF THE COST TO FIRMS OF MAINTAINING EXCESS INVENTORIES. THIS PROGRAM, DESIGNED TO SUPPORT FIRMS WHICH BUILD UP UNWANTED INVENTORY AS A RESULT OF NOT LAYING OFF LABOR, WOULD HAVE ENDED IN 1976. PRESENT PLANS CALL FOR THE PROGRAM TO CONTINUE THROUGH JUNE 30, PROVIDING THAT FIRMS DO NOT REDUCE EXISTING EXCESS INVENTORIES BY MORE THAN 50 PERCENT. BOHMAN HAS NO ILLUSION THAT

INVENTORY LEVELS, WHICH HAVE ALREADY BEGUN TO APPROACH PHYSICAL LIMITS IMPOSED BY EXISTING STORAGE FACILITIES, CAN INCREASE IN 1977. HE HOPES, HOWEVER, THAT THE DECLINE WILL BE LESS THAN 1.5 PERCENT OF REAL GDP.

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9. AS INDICATED ABOVE, THIS BUDGET WILL CONTINUE PAST TRENDS TOWARD INCREASING THE PUBLIC SECTOR'S SHARE OF NATIONAL INCOME. ASSUMING THE KI AND GOVERNMENT FORECASTS ARE CORRECT, THE ACTUAL SHARE OF PUBLICS SECTOR CONSUMPTION WOULD RISE FROM 26 PERCENT OF GDP IN 1976 TO 26.8 PERCENT IN 1977.

10. THE TABLE BELOW IS THE KI FORECAST FOR THE DEVELOPMENT OF GDP AND COMPONENTS IN 1977. BECAUSE THE KI IS A SEMI-OFFICIAL BODY, ITS FORECAST BECOMES THAT OF THE GOVERNMENT (THE KI IN FACT WRITES MUCH OF THE ECONOMIC ANALYSIS PORTION OF THE BUDGET). TABLE 2 ALSO PRESENTS THE GOVERNMENT ESTIMATE OF THE IMPACT OF DIFFENT RATES OF INCREASE IN TOTAL LABOR COSTS. ALTERNATIVE I IS AN 8 PERCENT RATE AND ALTERNATIVE II REPRESENTS THE EFFECT OF AN INCREASE OF 10.5 PERCENT.

TABLE 2

FORECAST OF SWEDEN'S GDP AND GDP COMPONENTS - CY 1977

| BIL  | PERCENT CHANGE IN VOLUME |        |        |        |
|--|--------------------------|--------|--------|--------|
| KRONA                                      |                          |        |        |        |
| 1976                                       | 76/76                    | 77/76  |        |        |
|  | ALT I                    | ALT II |        |        |
| PRIVATE CONSUMPTION                        | 171.6                    | 3.3    | 2.5    | 2.8    |
| PUBLIC CONSUMPTION                         | 84.2                     | 2.9    | 3.5    | 3.4    |
| GROSS INVESTMENT                           | 66.2                     | -1.7   | 3.6    | 3.4    |
| INVENTORY ACCUMULATION (AS PERCENT OF GDP) | 5.6                      | (-1.1) | (-1.4) | (-1.4) |
| PLUS EXPORTS                               | 80.8                     | 7.0    | 7.4    | 6.6    |
| LESS IMPORTS                               | 82.7                     | 1.9    | 2.7    | 2.7    |

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PRODUCT 322.8 1.0 1.7

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11. SWEDEN'S INTERNATIONAL ACCOUNTS LOOK EVEN WORSE THAN THEY MIGHT, BOHMAN ADMITS, AS A RESULT OF EXPANSIONARY FISCAL POLICY. THE SKR 11.3 BILLION CURRENT ACCOUNTS DEFICIT MENTIONED ABOVE INCORPORATES A 3 BILLION KRONOR TRADE DEFICIT AND A 9 BILLION KRONOR DEFICIT ON SERVICES AND TRANSFERS. THE CUMULATIVE DEFICIT BETWEEN 1974 AND 1977 COULD REACH AS MUCH AS SKR 31 BILLION. ACCORDING TO BOHMAN, THE SWEDISH ECONOMY WILL NEED TO BORROW 16 TO 18 BILLION MORE KRONA ABROAD THAN IT LENDS TO MEET THIS DEFICIT. ALTHOUGH THE LION'S SHARE OF THIS BORROWING SHOULD BE DONE BY THE PRIVATE SECTOR, THE GOVERNMENT HAS MADE THE DIFFICULT DECISION TO BORROW ABROAD DIRECTLY. THUS, FOR THE FIRST TIME IN THIS CENTURY, THE RIKSBANK WILL BE ENTERING INTERNATIONAL MONEY MARKETS IN 1977. ANY OTHER ACTION, SAYS BOHMAN, WOULD NOT BE COMPATIBLE WITH SWEDEN'S DETERMINATION TO REMAIN WITHIN THE WESTERN EUROPEAN CURRENCY SNAKE. TABLE 3 SHOWS THE 1977 FORECAST, INCLUDING THE GOVERN-

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## MENT'S TWO ALTERNATIVE HYPOTHESES.

TABLE 3

BALANCE OF PAYMENTS: 1975-1977

|                                   | 1975  | 1976  | 1977   |        |
|-----------------------------------|-------|-------|--------|--------|
|                                   | ALT I |       | ALT II |        |
| EXPORTS                           | 72012 | 80770 | 88660  | 88870  |
| IMPORTS                           | 74000 | 82670 | 91400  | 91620  |
| BALANCE OF TRADE -1988            | -1900 | -2740 |        | -2750  |
| BALANCE ON SERVICES AND TRANSFERS | -4772 | -6770 | -8610  | -8630  |
| CURRENT ACCOUNT BALANCE           | -6766 | -8670 | -11350 | -11380 |

12. IN DISCUSSIONS OF THE FOREIGN SECTOR, IN ITS PRESENTATION OF THE NEED TO DAMPEN PRIVATE CONSUMPTION, IN FACT THROUGHOUT THE BUDGET DOCUMENT AND ON SWEDISH TELEVISION, THE GOVERNMENT HAS REPEATEDLY EMPHASIZED THE NEED TO HOLD DOWN WAGE DEMANDS IN THE CURRENT COUNTRY-WIDE NEGOTIATIONS. ALTHOUGH THE BUDGET ACTUALLY ENTER-TAINS THE POSSIBILITY OF THREE DIFFERENT LEVELS OF INCREASE IN TOTAL HOURLY LABOR COSTS, 8, 10.5, AND 15 PERCENT, ONLY THE TWO LOWER ALTERNATIVES ARE GIVEN IN THE DETAILED ESTIMATES OF THE EFFECT LABOR COSTS HAVE ON THE ECONOMY (SEE TABLE 2 ABOVE). BOHMAN HAS, IN FACT, ATTEMPTED THROUGHOUT TO ILLUSTRATE THAT 8 PERCENT IS THE HIGHEST ACCEPTABLE RATE OF INCREASE. THAT 8 PERCENT WOULD MEAN WAGES COULD INCREASE NO MORE THAN 5 PERCENT. HE HAS ALSO HINTED ON SEVERAL OCCASIONS THAT SHOULD LABOR COSTS RISE BY MORE THAN 8 PERCENT THE GOVERNMENT MIGHT FIND IT NECESSARY TO STERILIZE EXCESS INCOME BY INCREASING THE VALUE ADDED TAX.

13. ALTHOUGH LABOR COSTS AND HIGH EXPORT PRICES RECEIVE CONSIDERABLE AND REPETITIVE ATTENTION IN THE GOVERNMENT'S ANALYSIS, NOT QUITE SO MUCH TIME IS DEVOTED TO INFLATION, LIMITED OFFICIAL USE

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PER SE. THE GOVERNMENT EXPECTS THE YEAR-ON-YEAR RATE OF INCREASE IN THE COST-OF-LIVING INDEX TO GO DOWN FROM 9.8 PERCENT IN OCTOBER OF 1976 TO AN AVERAGE AROUND 6 PERCENT FOR 1977 AS A WHOLE. THIS RATE OF INCREASE IS, OF COURSE PREDICATED ON AN 8 PERCENT INCREASE IN TOTAL LABOR COSTS AND AN EFFECTIVE PROGRAM TO DAMPEN PRIVATE CONSUMPTION. THE OECD HAD FORECAST A 9 PERCENT INCREASE IN SWEDISH CONSUMER PRICES IN 1977 BEFORE THE EXPANSIONARY MEASURES ANNOUNCED IN THIS BUDGET WERE KNOWN. NOTE, HOWEVER, THAT AT LEAST HALF

OF THE MEASURES TO DAMPEN CONSUMPTION WOULD NOT BE REFLECTED IN THE CPI, UNLIKE, SAY, AN INCREASE IN THE VALE ADDED TAX.

14. AS INDICATED ABOVE, THE SECOND HALF OF THE BUDGET, THE MINISTERIAL AND FUNCTIONAL BREAKDOWNS, DOES NOT DIFFER MARKEDLY FROM RECENT BUDGETS. PERHAPS THE MOST INTERESTING SEGMENT OF THE MINISTERIAL BUDGETS IS ENTRY XVI WHICH SHOWS THAT THE GOVERNMENT HAS FOUND IT ADVISABLE TO HOLD SJR 4 BILLION IN RESERVE FOR CONTINGENCIES. THIS IS THE LARGEST SUCH CONTINGENCY FIGURE ON RECORD.

TABLE 4

THE SWEDISH BUDGET

SOME PROPOSED EXPENDITURE APPROPRIATIONS FY 1978

(IN MILLIONS OF SKR)

|   |         |
|---|---------|
| III FOREIGN MINISTRY                    | 3,971   |
| IV DEFENSE MINISTRY                     | 11,476  |
| V HEALTH AND SOCILA WELFARE<br>MINISTRY | 34,792  |
| IX EDUCATION MINISTRY                   | 16,747  |
| XVI CONTINGENCY RESERVE                 | 4,000   |
| TOTAL BUDGET EXPENDITURE                | 125,000 |

(SOURCE: BUDTET BILL NO. 1976/77:100, APPENDIX 2, TABLE 11)

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(SOURCE: BUDGET BILL NO. 1976/77:100, APPENDIX 2, TABLE 88)

15. THE FUNCTIONAL BREAKDOWN OF SPENDING GIVEN BELOW IS EVEN MORE INTERESTING. NOTE THAT SPENDING ON NATIONAL DEBT (ITEM 6), CHILD SUPPORT (ITEM 5), PRICE SUBSIDIES FOR FOOD ITEMS (ITEM 12) AND FOREIGN AID (ITEM 11) ALL INCREASE SUBSTANTIALLY. SOCIAL WELFARE INCLUDES A 300 KRONOR PER YEAR INCREASE IN FAMILY ALLOWANCES FOR EACH CHILD (JANUARY 1978). AID TO CUBA WILL ACTUALLY DECREASE FROM 40 MILLION KRONOR TO 35 MILLION. IN FY 1978, AND THE TOTAL AID PACKAGE WILL AGAIN EXCEED 1 PERCENT OF GDP; 500 MILLION KRONOR OF THE TOTAL IS IN TIED AID AND ONE-THIRD OF THE TOTAL GOES THROUGH MULTILATERAL CHANNELS. VIETNAM IS STILL THE LARGEST SINGLE RECIPIENT OF SWEDISH AID AT 350 MILLION KRONOR.

16. SPENDING ON TOTAL NATIONAL DEFENSE (ITEM 3 OF TABLE 5) AND THE FIGURES FOR THE MINISTRY OF DEFENSE ARE LIMITED OFFICIAL USE

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STRICTLY HOLDING FIGURES. ACTUAL AMOUNTS WILL BE PROPOSED AFTER THE RIKSDAG HAS RECEIVED IN MARCH THE REPORT OF THE COMMISSION NOW STUDYING SWEDEN'S DEFENSE NEEDS. THAT COMMISSION WILL PROPOSE A FIVE-YEAR DEFENSE BUDGET FRAMEWORK.

TABLE 5  
SWEDISH BUDGET EXPENDITURES -  
FY 1978 BY FUNCTION  
(IN MILLIONS OF SKR)

| USE                                   | BUDGET<br>PROPOSAL<br>FY 1978<br>SKR | CHANGE COMPARED WITH<br>FY 1977 BUDGET<br>MILLIONS<br>PERCENT |
|---------------------------------------|--------------------------------------|---|
| 1. PENSIONS, ETC.                     | 23,020                               | (PLUS 2,100) (PLUS 10)  |
| 2. EDUCATION & RESEARCH               | 17,300                               | (PLUS 1,840) (PLUS 02)  |
| 3. TOTAL DEFENSE                      | 11,980                               | (PLUS 810) (PLUS 7)   |
| 4. COMMUNICATIONS &<br>ENERGY SUPPLY  | 9,270                                | (PLUS 860) (PLUS 10)  |
| 5. FAMILY<br>ASSISTANCE               | 7,870                                | (PLUS 1,460) (PLUS 23)  |
| 6. NATIONAL DEBT<br>INTEREST          | 6,400                                | (PLUS 1,300) (PLUS 25)  |
| 7. HOUSING POLICY                     | 6,110                                | (PLUS 640) (PLUS 12)  |
| 8. TAX ALLOTMENT TO<br>MUNICIPALITIES | 5,820                                | (PLUS 520) (PLUS 10)  |
| 9. LABOR MARKET POLICY                | 5,690                                | (PLUS 360) (PLUS 7)   |

10. COURTS & POLICE 4,650 (PLUS 410) (PLUS 10)  
11. DEVELOPMENT  
ASSISTANCE 3,540 (PLUS 430) (PLUS 14)  
12. FOOD SUBSIDIZATION 3,250 (PLUS 670) (PLUS 26)  
13. INDUSTRIAL & BUSI-  
NESS SUPPLRT 2,100 (PLUS 300) (PLUS 16)  
14. CULTURE & RELIGION 610 (PLUS 110) (PLUS 22)  
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15. MISCELLANEOUS 17,390 (PLUS 2,010) (PLUS 12)

TOTAL BUDGET  
EXPENDITURE 125,000 (PLUS 13,820) (PLUS 12)

(SOURCE: BUDGET BILL NO. 1976/77:100, APPENDIX 2, TABLE 1)

17. BY ADOPTING AN EXPANSIONARY FISCAL POLICY, WHILE SIMULTANEOUSLY TRYING TO HOLD DOWN PRIVATE CONSUMPTION AND IMPORTS, THE GOVERNMENT HAS ACHIEVED AN ENVIABLE 50/50 SPLIT IN THE PUBLIC RESPONSE. HALF OF THE COMMENTATORS BELIEVE THE GOVERNMENT HAS FAILED TO HOLD THE LINE AGAINST INFLATION. THE OTHER HALF ARE AFRAID THE GOVERNMENT IS BEING TOO RESTRICTIVE AND MIGHT FORCE THE ECONOMY INTO A RECESSION IN 1977.

18. THE SOCIAL DEMOCRATS, AND THEIR ALLIES, ORGANIZED LABOR, BELIEVE THE GOVERNMENT'S PICTURE OF THE ECONOMY IS TOO BLEAK, AND THAT UNNECESSARY BLAME FOR INFLATION IS PLACED ON WAGE EARNERS. AT THE SAME TIME, FORMER PM PALME HAS REACHED THE UNPRECEDENTED CONCLUSION THAT THE BUDGET IS TOO EXPANSIVE AND SHOULD BE CUT BACK. IF HE WERE IN POWER, HE SAYS, HE WOULD CERTAINLY HAVE INCREASED PAYROLL TAXES (PAID BY THE EMPLOYERS) TO 3 PERCENT RATHER THAN 1.5.

19. THE FEDERATION OF SWEDISH INDUSTRIES IS QUITE WORRIED ABOUT INFLATION, HAS MISGIVINGS ABOUT THE DECISION TO INCREASE FOREIGN BORROWING DRASTICALLY, AND FEARS A DEVALUATION WILL BE UNAVOIDABLE. RUDOLF JALAKAS, HIGHLY RESPECTED CHIEF ECONOMIST OF THE SVENSKA HANDELSBANK, BELIEVES THAT THE BUDGET IS TOO EXPANSIONARY, PROVIDING JOBS IN THE SHORT RUN, BUT ALLOWING BIGGER PROBLEMS TO PERSIST INTO THE LONGER RUN. HE ALSO SEES DIFFICULTIES IN MAINTAINING THE VALUE OF THE KRONA WITHIN THE SNAKE. SEVERAL ECONOMISTS, INCLUDING TWO OF THE 'FOUR WISE MEN'

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WHO PRODUCE AN ANNUAL ECONOMIC FORECAST, BELIEVE THE BUDGET IS NOT SUFFICIENTLY EXPANSIONARY AND FEAR A RECURRENCE OF THE 1971 RECESSION. THESE ECONOMISTS BELIEVE THE SWEDISH ECONOMY CAN STAND A SIGNIFICANT INCREASE IN ITS FOREIGN DEBT. ON THE POSITIVE SIDE, ONE OF THE WISE MEN EVEN SAID THE BUDGET WAS 'RATIONAL AND REASONABLE.'

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ACTION EUR-12

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-04 H-01 INR-07 L-03

NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 USIA-06

AID-05 COME-00 EB-07 FRB-03 TRSE-00 XMB-02 OPIC-03

CIEP-01 LAB-04 SIL-01 OMB-01 STR-04 CEA-01 AGRE-00

/090 W

-----140633Z 038205 /12

R 131456Z JAN 77

FM AMEMBASSY STOCKHOLM

TO SECSTATE WASHDC 9528

INFO AMEMBASSY COPENHAGEN

AMEMBASSY HELSINKI

AMEMBASSY OSLO

USMISSION OECD PARIS

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20. ON ONE THING ALL OBSERVERS ARE AGREED: THE NEW BUDGET IS REMARKABLY LIKE THE BUDGETS PRESENTED BY THE SOCIAL DEMOCRATS IN RECENT YEARS SAYS ONE: 'YOU NEED A MAGNIFYINGGLASS TO FIND SIGNS THAT THE BUDGET HAS BEEN DRAFTED BY NON-SOCIALISTS.'

21. EMBASSY COMMENT: THIS BUDGET GRAPHICALLY DEMONSTRATES THAT A MODERN GOVERNMENT CANNOT CHANGE HORSES IN MID-STREAM. IT ALSO ILLUSTRATES THE NARROWNESS OF THE DIVISIONS BETWEEN THE VARIOUS PARTIES IN THE SWEDISH POLITICAL SYSTEM AND PROVES WHAT HAPPENS WHEN YOU TRY TO SATISFY BOTH SIDES OF AN ARGUMENT. TO BE REALISTIC, HOWEVER, VERY LITTLE MORE COULD HAVE BEEN EXPECTED AT THIS TIME. FOR THE GOVERNMENT TO HAVE COME UP WITH NEW AND RADICAL DEPARTURES

WITHIN THE FIRST 100 DAYS IS JUST TOO MUCH TO EXPECT,  
AND THE AUTOMATIC NATURE OF MANY BUDGET ITEMS GREATLY  
LIMITS THE SCOPE FOR CHANGE. ON THE WHOLE, WE ALSO  
ACCEPT THE GOVERNMENT'S GENERAL ASSESSMENT OF THE ECONO-  
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MIC SITUATION WITH THE RESERVATION THAT THE PICTURE  
HAS BEEN MADE SOMEWHAT MORE BLEAK THAN NECESSARY IN  
ORDER TO BRING PRESSURE ON LABOR. SWEDEN IS STILL IN A  
POSITION TO FINANCE CURRENT ACCOUNT DEFICITS FOR ONE  
OR EVEN TWO MORE YEARS. ITS INTERNATIONAL CREDIT RATING  
IS IMPECCABLE AND THE MORE THAN SKR 30 BILLION IN INTER-  
NATIONAL DEBT WHICH THE SWEDES WILL HAVE ACCUMULATED BY THE  
END OF THE YEAR IS STILL ONLY 1.5 PERCENT OF GDP AND LESS  
THAN 3.5 PERCENT OF TOTAL EXPORTS. THE DANGER WE SEE  
IS THAT THE PSYCHOLOGICAL EFFECT OF THIS EXPANSIONARY  
BUDGET IS LIKELY TO TRIGGER SPECULATION AGAINST THE  
KRONA. IT MAY ALSO ENCOURAGE PRIVATE SWEDISH BORROWERS TO  
POSTPONE FOREIGN BORROWINGS IN ANTICIPATION OF A DEVALU-  
ATION.

22. WE WOULD ALSO POINT OUT, IN REPLY TO CRITICISM THAT  
THE BUDGET IS TOO EXPANSIONARY, THAT THE 15 BILLION KRONOR  
DEFICIT IS PREDICATED ON THE 8 PERCENT INCREASE IN TOTAL  
LABOR COSTS. IF THAT FIGURE IS EXCEEDED BY AT LEAST 3  
PERCENT (AS WOULD CERTAINLY SEEM LIKELY) THEN INCOMES AND  
GOVERNMENT REVENUE WOULD RISE ACCORDINGLY AND THE DEFICIT  
WOULD DROP. WE NOTE ALSO THAT THE GROWTH RATE OF BUDGET  
EXPENDITURES AND THE DEFICIT (7 AND 9 PERCENT RESPECTIVELY)  
IS LESS THAN THE RATE OF INFLATION IN 1976 AND LIKELY TO  
BE LESS THAN THE RATE FOR 1977.

23. FOR US THE KEY QUESTION IS HOW QUICKLY THE GOVERNMENT  
CAN COME TO GRIPS WITH THE NEED TO RESTRUCTURE THE ECONOMY  
AWAY FROM HIGH COST INDUSTRIES SUCH AS TEXTILES, SHOES,  
AND CRYSTAL GLASS, AND HOW QUICKLY INDUSTRY CAN RATION-  
ALIZE PRODUCTION IN AREAS SUCH AS SPECIALTY STEEL. SUCH  
AN EFFORT COULD SOLVE SWEDEN'S CURRENT PROBLEMS, WHILE  
MAINTAINING HIGH EMPLOYMENT, BUT ACTION MUST BE TAKEN  
SOON. SHOULD WAGES GO UP MORE THAN THE GOVERNMENT'S  
GUIDELINES, IT WILL IMMEDIATELY FACE A DECISION AS TO  
WHETHER IT WILL INCREASE VALUE ADDED TAXES OR DEVALUE  
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THE KRONA. WITH THE LIKELIHOOD IN MIND THAT LATER PRES-  
SURES ON THE KRONA MIGHT FORCE DEVALUATION AND THUS

INCREASE THE COST OF GOVERNMENT BORROWING ABROAD, WE  
SUSPECT THAT THE LATTER MAY BE IN STORE.

24. NONE OF THIS SHOULD GREATLY CONCERN THE US. DEMAND  
FOR US IMPORTS WILL CONTINUE TO GO UP AT A RESPECTABLE  
RATE AND WE ARE LIKELY TO MAINTAIN OUR CURRENTLY FAV-  
ORABLE BALANCE OF TRADE WITH SWEDEN. WE WILL UNDOUBT-  
EDLY HEAR MORE PLEAS TO STIMULATE THE US ECONOMY AND  
THUS SWEDISH EXPORTS AND THE ECONOMIES OF WESTERN EUROPE.  
IN FACT, BOHMAN WAS QUOTED IN THE PRESS AS SAYING THAT  
HE TRUSTED THE US WOULD SAVE SWEDEN. NONE OF THIS IS  
NEW.  
SMITH

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## Message Attributes

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**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** GOVERNMENT BUDGET  
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**Copy:** SINGLE  
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**Disposition Approved on Date:**  
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**Executive Order:** N/A  
**Errors:** N/A  
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**To:** STATE  
**Type:** TE  
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**Review Markings:**  
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